

MINUTES OF THE UTAH CAPITAL INVESTMENT BOARD

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April 14, 2015 – 2:00 pm

Utah Governor's Office of Economic Development, 60 E South Temple, Salt Lake City, UT

Board Members Present: Bob Majka, Samuel Straight, Richard Ellis, Val Hale (phone)

Guests: Jeff Van Hulten, Susan Eisenman, Bret Jepsen, Richard Pugmire

Staff: Kathy Whitehead

Welcome and Related Business:

Bob Majka welcomed board and guests, and with confirmation of a quorum, moved to agenda item II, approval of the Q4 2014 Utah Capital Investment Board Meeting Minutes. Richard Ellis moved to accept the minutes as presented, and Samuel Straight seconded the motion. The board unanimously approved the minutes.

The board then moved to item III, approval of the January 2015 Utah Capital Investment Board Special Session Minutes. Samuel Straight moved to accept the amended version of the minutes as presented. Richard Ellis seconded the motion. The board unanimously approved the minutes.

Susan Eisenman clarified that the draft minutes from the closed session of the January special board meeting are protected under GRAMA and are not published, although if there are errors or points of concern, these should be brought to Kathy Whitehead's attention. There is no requirement for a motion to approve the draft minutes of the closed session. They are simply required to be kept as a record.

Item IV. UCIC Presentation

Bret Jepsen (UCIC) first updated the board on significant legislative changes of 2015 general session and key takeaways. Mr. Jepsen showed a comparison of current legislation compared to last year. He remarked that if the legislation would have been run as it was originally intended, it would have put UCIC in jeopardy with creditors, tax credits, etc. He contrasted that with the 2015 legislative session and discussed the opportunities to meet with legislators one-on-one and set the record straight, paving the way for a smooth legislative approval.

Accomplishments:

- Cleanup
 - Include "private equity" when venture capital is stated – important to building a safe portfolio; private equity big source of capital for economic growth
 - Reassign Annual Report to UCIC from UCIB since UCIC has all the data
 - Clarify UCIC Chair's role term and mandatory UCIC Board disclosures – every year board members required to disclose personal venture capital private equity holdings

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- Insert “qualified investment professionals” into legislation – ensure succession planning
- Adopt Incentive-based Tax Credit structure - protections inasmuch as UCIC can demonstrate bringing revenue into Utah
- Retired \$20M of tax credits for UFOF I
- Secured \$25M of new tax credits for UC2 – rather than fund size at \$75M, now have ability to raise up to \$100M and achieve tax credits

Bob Majka asked whether, even with the additional \$25M, this fund had enough money behind it. Bret Jepsen commented that it was a good safe number, and he wasn't convinced that having more money in the fund created better relationships. In Bret's view, it's about reputation; it's about being helpful to managers. They need to know we're going to send them our best companies and hope they will then invest.

Richard Pugmire added that this communicates confidence in the program to the markets. The size of the fund will not determine our influence. Our relationships will determine our influence. It's important to remember that UCIC has relationships beyond its \$100M funds.

Bob Majka then asked whether there had been a mindset change that suggested we needed to focus more on state of Utah investments. On balance we have about 15% of our dollars in Utah. Did these changes require us to bump this up? Bret responded that the message UCIC received from this legislation was, “We don't want you to cash tax credits. We like what you're doing, but we want you to do it profitably.” Bret gave the example of an investor that would like to be doing more in Utah. When you look at the return on the 15%, it's close to two times our money, which is a great return. But, the greater market in Utah has not returned anything close to two times. Bob confirmed that the message was clear -- with the 2015 legislature, UCIC's main task was not to cash tax credits. As Bret suggested, UCIC's job is to do all the things around the investing (introductions, events, etc.) that reduce the risk.

Bret then gave examples of incentive-based tax credits:

<u>UFOF I Examples:</u>
<ul style="list-style-type: none"> ▪ UFOF I Fund Size = \$122 mm ▪ If Incentive-based Tax Credit structure, measurable value includes: <ul style="list-style-type: none"> ☐ Invested capital = \$17 mm (\$39 mm Value) ☐ Utah-based company and fund introductions: <ul style="list-style-type: none"> ▪ \$20 mm intro for Mercato Partners, resulting in \$15 mm invested into Utah ▪ ? mm intro for Utah-based company introductions ▪ 2012 BEBR evaluation (Direct Impact) = \$85 mm
TOTAL Incentive Awarded as of 9/30/14 \$139 mm

<u>UC2 Examples:</u>
<ul style="list-style-type: none"> ▪ Utah Capital II Fund Size = \$100 mm ▪ 3/15 Legislated Incentive-based Tax Credit structure: ▪ Higher of Invested vs Value capital = \$25 mm (est) ▪ Utah-based company introductions: <ul style="list-style-type: none"> ☐ \$2 mm Utah-based company introduction ☐ \$25 mm intro for Utah-based VC firm, resulting in \$5 mm invested into Utah ☐ \$50 mm intro for Utah-based PE firm, resulting in \$20 mm invested into Utah ▪ TBD BEBR or other 3rd party economic evaluation = \$48 mm
TOTAL Incentive Awarded by Year 5 (est) \$100 mm

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Bret made mention that he thinks the legislative rules are going to call for a third party evaluation of UCIC's direct impact. In speaking to the UC2 example, UCIC office made \$25M introduction from California-based pension to a Utah-based VC firm, and also helped with a \$50M non-Utah based pension introduction to a Utah-based PE firm. Though these firms are not going to invest 100% of their capital in Utah, but they will still invest significantly. So, we are well on our way to achieving the measurable, which Brad Wilson has emphasized – we need measurables that are defensible.

Samuel asked whether the legislature felt comfortable with the way the numbers are derived in the examples. Bret responded that this is really in the stages of defining the measurable in rules with Susan. Susan added that this is the basis of how the board would award tax credits should we get several years down the road and the fund hasn't paid out. Instead of guaranteed tax credit, it would be based on how much money proportionally was invested in the fund, and the economic benefit of the fund.

Bob Majka asked in the case of the UC2 fund, when investors would expect their return. Richard Ellis explained that they are locked in for an investment period. Bob then asked about the funds, and "churning". Bret answered that on UFOF 1, as soon as debt is retired, then we can churn that. On UC2, the limited partnership agreement in place for our investors – it is very clear they don't want money re-invested, they want the money back to them.

Bret asked if there were any questions on this part of the presentation. There were none, so Bret then discussed other things UCIC is doing to promote economic development. One thing was presenting the Utah Data and Analytics Summit. They were able to draw some influential companies and spokespersons. Over 250 attended, entrepreneurs, students, professionals. Richard asked whether the panelists were positive about the conference. Bret mentioned that they were. The panelists came on their own dime. It was a great environment for building relationships and making introductions to Utah. They were able to get NEA (Bay Area), Insight (NYC), Accel Partners (Palo Alto), Polaris Partners (Boston), Zetta Venture Partners (Salt Lake City). Several of these will also speak at the Venture Capital Conference. This will be a great opportunity for companies seeing great results in Utah to speak to their experience.

Richard Pugmire also presented fund performance update. Final Q4 performance expected to be published mid-May because it is audited by external auditors. Q4 expected to be up about \$13M, and will be one of largest gains we've ever had; in perspective, in the entire history of program since 2006, this is first year it has been profitable from a net asset value vs. debt. So for the first time, because of strong performance in portfolio, we've been seeing nice distributions. The delta between assets and debt is about \$13M. The debt balance is about \$97M; and the cash-adjusted NAB is up to about \$112M. This is the funds reporting their quarterly valuation.

Richard Ellis asked what our total distribution was last year. Richard Pugmire responded that it was \$12M. Bob asked if there was any estimate projected for this year. Mr. Pugmire stated we want to see it about \$15M this year.

Bob Majka asked what the interest payment is annually. Bret answered roughly 3-4% or just under \$4M. Bob Majka asked if we'll use profits to reduce the debt. Bret and Richard both answered that yes, we're repaying debt as fast we can.

Bob Majka asked where we are on selling existing portfolio? In response, Bret presented a slide with three options for decisions on portfolio financing as shown below:

Merits and Considerations of Fund I Financing Options		
Option	Merits	Considerations
Current Financing	<ul style="list-style-type: none"> • No additional fees • Appears to be adequate structure until October 22, 2017 (maturity date) • Receive more insight into performance before refinancing 	<ul style="list-style-type: none"> • Refinancing will need to be communicated by June 15, 2016 (loan requirement) • Interest rate / credit risk on refinancing • Uncertain cash flow timing and required principal payments
Debt-based Refinancing	<ul style="list-style-type: none"> • Extend maturity beyond 2017 to better match cash flow expectations • Take advantage of current low rates • Utah Capital receives any portfolio gains 	<ul style="list-style-type: none"> • Higher break-even return than equity-based refinancing due to interest cost • Uncertain cash flow timing could increase interest costs or make it difficult to meet required payments
Equity-based Refinancing	<ul style="list-style-type: none"> • Cash flow timing not as significant a risk (depending on ultimate structure) • Lower break-even return than debt-based refinancing 	<ul style="list-style-type: none"> • All or most of any gain goes to equity holders • Less flexibility in managing fund and organization

He pointed out that they are constantly looking for a way to protect some of our downside while making more upside.

Richard Ellis commented that he assumed we're looking at another 5 year rollover with the banks on this. Bret confirmed this, stating we have two strong bank relationships.

As Bret and Richard explained the advantages and disadvantages of these options, Susan asked, "If you're refinancing Fund 1 and starting Fund 2 at the same time, are the two different structures going to make Fund 1 more attractive, making it more difficult to get investors for Fund 2?" Bret didn't think so. He explained in Fund 1, there are perhaps one-third of the

managers many people don't recognize, making it tough to identify full value. In Fund 2, you are going to see premier managers, giving the two funds different sets of investors.

Susan observed the hard part for the board will be the need to have two different sets of rules and policies; one for the refinance and one for going forward. Because she was trying to write two sets of rules, it may require some review to address. Bret mentioned he thought it was a good start, but because the rules seem to suggest we're guaranteeing a return on Fund 2, we need to exercise caution. Susan mentioned she will work to clean those up.

Richard Ellis asked about what UCIC is doing to replace Matt, who recently left UCIC. Bret pointed out that Matt is familiar with the uniqueness of the funds. However, Bret has some exciting leads for filling the void. The two he is most enthusiastic about understand how to use data analytics, and as the fund comes on board, UCIC will move forward. Bret also touched on his and Richard's interest in trying to follow the trends and data points that will help them understand customers better on the economic development front.

Samuel asked whether there was a deadline for the rules to be submitted. Jeff van Hulten suggested we had 180 days from effective date of House Bill 411, so 180 days from May 12. Bob Majka asked whether there were administrative rules blessed last year. Susan affirmed this was true, but that those weren't done in time, whereas these will be done in plenty of time. Richard Ellis clarified that because we changed the game, we needed to change the legislative rules.

Because members of the board stated their need to leave at this stage of the meeting, Mr. Majka moved to Item V of the agenda, policies and procedures. Susan explained that we have some time to consider changes we want to make in light of new statutory scheme. She will change the rules, and run past the board and the tax commission.

Richard stated we just need to have them in place before we start Fund 2. Bob asked UCIC if there was a day they wanted to target for launching Fund 2, so we could get an estimate for scheduling the completion of the rules. Bret responded that he was anxious to kick this off, and asked the board whether it was comfortable with him passing the rules as written along to Cooley for review and comment.

Richard Ellis felt it useful to get their input. Other board members felt it would save time and effort to do this. Susan would like to review and revise the rules, and then submit to Bret to forward to Cooley.

Bob Majka asked the board whether everyone was comfortable doing this. The board unanimously agreed that UCIC could move forward with the caveats in place, and the record shows board is comfortable with UCIC moving forward.

Susan then stated that before the quorum dissolved, she wanted to express her belief that there is value in hiring a securities attorney for the board to review everything to assure the board is on solid ground from a securities standpoint. Bob mentioned that the board has no money to pay for this. Susan assured the board UCIC will pay these fees. Susan's office would contract with the securities attorney, and she believes that the services and opinion letter she would seek from the attorney would be well under the \$250,000 maximum that would qualify as a small purchase.

Bob Majka brought up that the last item the board needs to consider quickly are nominations for board members, since several members' terms will expire in 2015, and there are many significant items for the board to consider. He asked members to send their recommendations to him for consideration.

In terms of calendaring board meetings, it was decided to keep the dates as posted, and check schedules closer to scheduled dates.

Richard Ellis made the motion to adjourn and Val Hale seconded. The meeting adjourned at 3:07 pm.